

DEFENSE CONTRACT AUDIT AGENCY
APPLICATION OF AGREED-UPON PROCEDURES
TO CONTRACTOR'S CERTIFICATION AND AGREEMENT WITH DSCA

Contractor's Name: _____

Assignment Number: _____

Field Audit Office: _____

Date Assigned: _____

Supervisor's Signature Indicating _____ Date _____
Approval of the Procedures (Must be obtained before starting evaluation.)

A. BACKGROUND

1. The Secretary of Defense has designated the Defense Security Cooperation Agency (DSCA) as the director, administrator, and supervisor of the Security Assistance Program. Responsibilities are defined and authorized by the Foreign Assistance Act (FAA), of 1961 as amended; the Arms Export Control Act (AECA), as amended; and other applicable statutes, Executive Orders, and Directives. Foremost of these is the Security Assistance Management Manual, DoD 5105.38-M. Included within the Security Assistance Program is the Foreign Military Financing (FMF) Program, which provides loan and grant financing for Foreign Military Sales and purchases from U.S. firms, which are defined as Direct Commercial Contracts (DCC).
2. Under the FMS Program [Ref.: CAM 7-1307], the Department of Defense acts as the agent for the purchasing country. These procurements are fully subject to the FAR and audit oversight. However, this is contrasted with DCC procurements, which are between the foreign government and a U.S. firm -- with the U.S. Government performing reviews, approvals, and audits as a function of providing the financing. DSCA requests that DCAA apply agreed-upon procedures to determine if a contractor is in contractual compliance with the elements of the jointly signed Contractors Certification and Agreement with Defense Security Cooperation Agency (Certification and Agreement).
3. DCCs are agreements between the foreign government and a U.S. contractor, therefore, they are not subject to the Federal Acquisition Regulation (FAR) or the Cost

Accounting Standards (CAS). However, the Certification that DSCA requires all contractors to sign in order to receive financing provides for contractor compliance with certain concepts, procedures and financial constraints that are addressed in the FAR and DCAA's CAM.

4. Operatively, there are four different versions of the "Certification Agreement" and four different versions of the "Guidelines." These consist of two sets for Israel and two sets for all other countries. Each of these sets is further divided by time, since the latest revision became effective on or about January 1995. (The original certification was dated 1985.) Therefore, the auditor should carefully review the Contractor's Certification to ensure that the appropriate version is being evaluated.
5. These agreed-upon procedures are based on the January 1995 Certification and Agreement, and should be revised for procedures applied to evaluate compliance with earlier versions of the Agreement. On November 4, 1991, the Office of the Comptroller, DoD, issued a memorandum with an attachment entitled: "Organizational Responsibilities - Audits of Private Firms Under the Foreign Military Financing Program." The attachment outlines the responsibilities of DSCA and DCAA regarding evaluations of direct commercial contracts and makes it clear that only certain elements of the Certification and Agreement are subject to evaluation by DCAA. These elements are listed in Section E.1 of these procedures. As usual, auditors should exercise judgment with respect to their treatment of other matters that come to their attention outside these elements.

B. PURPOSE AND SCOPE

1. The objective of these agreed-upon procedures is to provide auditors with tools needed to plan, perform, and report on their evaluation. It is intended to provide a logical sequence to the evaluation and reflects a mutual understanding between the DSCA and DCAA as to the scope required to meet GAGAS and DCAA objectives for the current assignment. Those steps not required should be marked "not applicable" (N/A).
2. The purpose of this evaluation is to apply procedures and to report on the contractors' compliance with specific elements contained in its signed Contractors Certification and Agreement. If the contractor is found to be in noncompliance with any of the certification elements, the auditor is to describe the situation and include the amount of any corresponding/related costs in the report for DSCA's disposition.
3. Before beginning this evaluation, the auditor should inquire about internal control reviews performed by the contractor or its external auditors relating to this area. In those cases where internal or external reviews have been performed, the auditor should follow guidance contained in CAM 4-1000, Reliance on the Work of Others. Before evaluating the internal controls, the auditor should determine that the system contemplated for evaluation is material to the government.

4. These procedures do not provide for the testing of individual transactions. It is expected that transaction test programs will be developed locally to permit the efficient gathering of evidential matter at individual locations.

C. REFERENCES

1. *Guidelines for Foreign Military Financing of Direct Commercial Contracts.* This DSCA guideline provides policies and procedures for the use of foreign military financing to fund direct commercial contracts between US industry and the government of foreign countries. The guidelines serves as a basis for the DSCA review of the foreign government's request for approval to use foreign military financing to fund direct commercial contracts. The scope of DCAA's evaluation focuses on the contractor's compliance with the signed Certification and Agreement. There is a guideline version for Israel and a version for all other countries.
2. *Contractors Certification and Agreement with Defense Security Cooperation Agency.* In consideration of a grant/loan, the contractor agrees to comply with the elements/provisions of the Certification and Agreement. The requirements imposed on the contractor by the Certification and Agreement are contractual and not regulatory. There is a Certification and Agreement version for Israel and a version for all other countries.
3. *Security Assistance Management Manual [SAMM], DoD 5105.38-M.* This manual provides DSCA's policies and procedures for administering US Military Assistance and Foreign Military Sales Programs and related activities.
4. AICPA Professional Standards AT 500, *Compliance Attestation*; AT 600, *Agreed-upon Procedures Engagements*
5. CAM 5-600, *Audit of Purchasing System Internal Control*; 7-1300, *Selling Costs*.
6. CAM 14-908, *Compliance Reviews for the Defense Security Cooperation Agency (DSCA)*
7. FAR 3.4, *Contingent Fees*.

D. PRELIMINARY PROCEDURES

1. DSCA will notify the contractor of the planned evaluations. A copy of the notification of intent to apply agreed-upon procedures letter is included in a "file folder." A file folder for each contractor selected is prepared by DSCA for use by DCAA. Generally, the contents of the file include the

			Auditor's Initial
	Staff Hours	W/P	and Date
	<u>Budget</u> <u>Actual</u>	<u>Ref.</u>	<u>Completed</u>

contractors Certification and Agreement, relevant correspondence, and “audit” leads. The file is provided to the DCAA auditor from DSCA through DCAA Headquarters.

2. Review the file folder, and then arrange for an entrance conference.
3. Review the FAO's permanent files and determine if vulnerability risk assessments made for the contractor's performance of Government contracts also apply to commercial contracts approved by DSCA.
4. Determine if there are any outstanding deficiencies previously reported from reviews of the contractor's internal controls that affect the evaluation.
5. Determine if there is a contractor purchasing system review (CPSR) that reported any deficiencies that affect the evaluation.
6. Review the contractor's policies and procedures that describe the process for ensuring compliance with the certification agreement. If the contractor states that written policies and procedures do not exist, request the contractor to prepare a written description of the procedures that are followed. Request the contractor to include references to the company's policies and procedures that mandate the process.
 - a. Evaluate the policies/procedures and determine if there are potential internal control weaknesses that could result in noncompliances with the certification agreement.
 - b. Determine if the accounting practices applicable to DSCA contracts have adverse cost impacts on the performance of US Government flexibly priced contracts performed in accordance with FAR and CAS provisions.
7. Review DSCA's file folder for the contract, contract modifications, and correspondence between the

foreign government, the contractor, and DSCA. Note any special provisions and/or agreements that might affect the items in the certification agreement and the evaluation for compliance.

8. Note the procedures described in the contract for the contractor's submission of invoices, i.e. predetermined scheduled submissions, milestone accomplishment(s), percentage of completion, deliveries, etc.
9. Summarize the results of the preliminary procedures.

E. AGREED-UPON PROCEDURES

Review the elements within the applicable Certification and Agreement. DCAA's evaluation of compliance is limited to the following elements* for Israel and other countries:

Element Description	Element Number
Flowdown of Terms & Conditions	4, 5, 6, 8
Commissions & other contingent fees	7, 12
Foreign Content	10, 11, 13
Down payments	14
Export transportation	15
Travel costs	16
Penalty, refund, & other reimbursement	19

* The referenced element numbers above corresponds with the numbered element in DSCA's January 1995 Certification & Agreements. The element description in DSCA's initial agreement dated 1985, and subsequent revisions have different element numbers from those listed above.

1. Elements 4, 5, 6 & 8 -- Flowdown of Terms & Conditions. Contractor agrees to include in the written terms and conditions of each such subcontract a statement that United States Government funds will be used to finance such subcontract and that acceptance of the subcontract

order will constitute acknowledgment of such notification of US Government (USG) financing.

- a. Randomly select from the contractor's records, the names of subcontractors from which significant purchases were made. Review the terms and conditions of these purchase orders and subcontracts to determine if they include the acknowledgment that US Government funds are used for financing.
 - b. Summarize the results of the evaluation.
2. Elements 7 & 12 -- Commissions & other contingent fees. - Contractor certifies that no bribes, rebates, gifts, kickbacks or gratuities, which were intended to secure the Purchase Agreement has been or will be directly or indirectly offered or given contrary to US law.
- a. Request a schedule from the contractor to show the names and amount(s) paid for commissions or other contingent fees to agent(s), broker(s), employee(s), consultant(s) or other recipient(s) for the contract.
 - b. Compare the amount(s) obtained in E.2a above with the information in the certification agreement and determine if the contractor is in compliance.
 - c. Review the terms and conditions of the agreements/contracts between the contractor and recipient(s) named in the certification agreement. Determine if the amount paid to date plus due to be paid through completion of the contract will result in noncompliance.
 - d. Request the contractor provide the names and amount(s) paid to any other agent(s), broker(s), consultant(s), employee(s), or recipient(s) used to market and/or sell the company's products in the buyer's country. Review the terms and conditions of their agreements and determine if

the amount(s) should be included in the schedule for E. 2a. above.

- e. Where applicable, request the contractor to furnish the cost for maintaining a sales office in the buyers' country. Review the expenses and determine if any amount(s) should be included in the cost schedule from E. 2a. above.
 - f. Review the FAO's incurred cost audit files for the contractor and determine if audit data and information (i.e. broker/sales agent(s) commission(s), consultant(s) fees, and employee(s) bonuses) corroborates the contractor's data and information furnished for E. 2d. and e. above.
 - g. While applying the procedures above (E. 2b. through f.) determine if any costs that are not charged direct to the contract were erroneously charged to flexibly priced US Government contracts.
 - h. Summarize the results of the evaluation.
3. Elements 10, 11, 13 -- Foreign Content. Contractor certifies that the material or components to be provided under the Purchase Agreement are manufactured and assembled in the US, purchased from US firms, and composed of US origin components. Agrees that, if DSCA approves financing of the dollar value of non-US origin components or services stated in the certification, or a specified dollar value of non-US origin content, this value will not be exceeded. The value of raw materials and common hardware items which are procured by a manufacturer from both US and foreign sources and which are not ordinarily segregated by origin, and which are incorporated on a interchangeable basis into the manufacturer's products, need not be identified.
- a. Request a schedule from the contractor that shows by supplier(s) [including affiliate(s), segment(s) and/or joint venture(s)] the dollar

value for non-US origin components or services and non-US manufactured items and components procured and known or expected to be procured through the time of completion of the contract.

- b. Compare the dollar value for non-US procurements with the amount noted in the certification agreement and determine if the contractor is in compliance.
- c. Selectively review the terms and conditions in subcontract(s), purchase order(s), and other agreements/arrangements for foreign suppliers. Verify that the amount for actual plus scheduled purchases, if any, agrees with the contractor's information provided for non-US procurements.
- d. Randomly select for evaluation from appropriate contractor's records, subcontractors' and vendors' invoices or billings along with the corresponding bills of lading, and receiving reports.
- e. Determine if the incoming shipments were made from domestic or foreign manufacturers.
- f. Verify the names for shipments made from foreign manufacturers with the contractor's information.
- g. Evaluate contract freight-in costs not evaluated in E.3d. above. Randomly select freight billings and determine if any are for foreign suppliers other than those identified in E.3a. above.
- h. Determine if the contractor maintains a qualified vendor list (QVL). Selectively compare the names of the suppliers for the performance of the contract with the names on the QVL. If significant purchases were made from suppliers that are not listed on the QVL, get an explanation from the contractor.

- i. Review the contractor's documentation for evaluating, screening and selecting the vendors.
 - j. Verify through Dun & Bradstreet or a similar reference that the vendor is a domestic manufacturer (not distributor).
 - k. Verify that the vendor is not listed on the ACO's list for vendors/contractors debarred from doing business with the Government.
 - l. If a satisfactory determination cannot be made for the origin of components and services from the procedures applied above, consider requesting assistance from the FAO cognizant of the subcontractor, if possible. Our right of access or right to information may be very limited.
 - m. Summarize the results of the evaluation.
4. Element 14 -- Down Payments. -- Contractor agrees to identify the full amount of any advance payment received under the Purchase Agreement in its accounting records as a down payment, to apply these funds solely to the performance of obligations under this Purchase Agreement, and to provide a clear audit trail on the use of these funds.
- a. Determine from DSCA's contract files, the purchase order implementation date between the contractor and buyer (foreign government). Review the contractor's recorded costs, if any, incurred prior to the purchase agreement implementation date.
 - b. Review the contractor's method for recording the amount received for the initial or down payment invoice. Advance payment is not to exceed 15 percent of contract price. Determine if the total amount received was applied toward performance of the contract.

- c. Selectively review the contractor's subsequent billings and determine if they were made as prescribed in the contract.
 - d. Summarize the results of the evaluation.
5. Element 15 -- Export transportation -- Agrees that export transportation costs financed under terms of the Purchase Agreement will be paid only to steamship, barge, tug, and airline companies of United States registry.
- a. Determine from DSCA's contract files whether export transportation costs for deliverable contract items are borne by the contractor or buyer (foreign government).
 - b. If export transportation costs are borne by the contractor:
 - (i.) Request from the contractor the name(s) of the transporting carrier(s), the country in which the carrier(s) is registered, and the amount paid to date.
 - (ii.) If the contractor uses freight forwarder(s) to manage exports, obtain their name(s) and the amount(s) paid to date. Review the freight forwarder(s) billing documentation and determine that the contract items were not exported by non-US registered carriers.
 - (iii.) Randomly select and review sales shipping lists (or packing sheets) for contract deliveries. Note the name of the carrier(s) and determine that export transportation was not furnished by non-US registered carrier(s).
 - c. Summarize the results of the evaluation.
6. Element 16 -- Travel costs -- Contractor certifies that the cost of transportation, lodging, meals and other personal support costs incurred by or on behalf of the purchaser's personnel relating in any

way to this contract will be paid by the purchaser, and that these costs will not be financed, in whole or in part, with funds received from the US Government under the Purchase Agreement either directly or indirectly.

- a . Evaluate contract costs for travel, transportation, lodging, meals and other personnel support expenses, and verify that none is for the foreign purchaser's personnel [neither for casual visit(s) nor training under the contract].
 - b . Evaluate the FAO's incurred cost audit files for the contractor, and determine that there are no travel expense exceptions that pertain to foreign government personnel.
 - c . Summarize the results of the evaluation.
- 7 . Element 19 -- Penalty, refund, & other reimbursement. Contractor agrees that any penalty payment, refund, or other reimbursement due to the purchaser pursuant to the Purchase Agreement will be paid to the US Government for credit to the FMS trust fund account of the purchaser.
- a . Evaluate the contractor's transaction(s) recorded for penalty payments, refunds, or other reimbursement made to the foreign government, and determine that the amounts are credited to purchaser's account.
 - b . Summarize the results of the evaluation.

F. CONCLUDING STEPS

- 1 . Summarize the results of the application of agreed-upon procedures.
- 2 . Complete the index and cross-reference the working papers.
- 3 . Discuss results with supervisor. Coordinate significant or unusual issues with DSCA.

- Coordination should be both before and after discussion with the contractor.
4. Prepare (for follow-up) audit lead sheets for disclosure of commercial contract costs erroneously charged to indirect accounts that will eventually be allocated to US Government flexibly priced contracts.
 5. Hold an exit conference with the contractor in accordance with CAM 4-304. Discuss each exception with the contractor and request a response for inclusion in the report.
 6. If the evaluation discloses information that raises suspicion of fraud or other illegal acts, refer the matter by completing DCAA Form 2000 (see CAM 4-700).
 7. Prepare the agreed-upon procedures report.
 8. Closing actions should be performed in accordance with FAO procedures. These procedures may require either auditors or administrative personnel to perform various closing steps. Completion of these closing actions should be documented in the working papers and should include:
 - a. If the report has been electronically transmitted to the customer, file the signed original report in the working paper package. Otherwise, file a copy of the signed report.
 - b. Include a printed copy of the final draft report containing the supervisory auditor's initials and date on the top page, cross-referenced to the working papers, in the working paper package. The final draft report should include all substantive changes made to the original draft, with cross-referencing updated as necessary. It should differ from the final report only due to minor administrative changes (spelling, format, etc.) made during final processing.

- c. Include an electronic version of the acknowledgement letter in the working paper package.
- d. Include hardcopy printouts of the Administrative and Working Papers indexes, including the supplemental listing of electronic files, in the working paper package.
- e. Ensure all working paper files are "read only" and, if necessary, compressed for final storage. Generally, current Agency software should be used to automatically modify all electronic files for storage.
- f. Two complete sets of electronic working papers must be prepared. The "original" set should be stored in the working paper package. The "archive" set is to be stored separately from the working paper package on removable media such as CD-ROM or diskette. If there will be a short-term need to access the working papers, a third, or "working" set should be stored so as to be available for reference, generally on the LAN. This set should be deleted when no longer needed.
- g. Verify that electronic files stored on removable media are not corrupted and can be unarchived.
- h. Securely enclose the "original" set of electronic files in the working paper package.

TOTAL